

Message Text

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ACTION ARA-06

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FM AMEMBASSY MEXICO

TO SECSTATE WASHDC IMMEDIATE 1427

C O N F I D E N T I A L SECTION 01 OF 02 MEXICO 04844

LIMDIS

E.O. 11652: GDS

TAGS: EFIN, MX

SUBJECT: CURRENT ECONOMIC SITUATION

1. SUMMARY: MEXICO'S ECONOMY, ACCORDING TO MOST ACCOUNTS, IS STAGNANT, WITH NO SIGNS OF AN OVERALL RECOVERY. ECONOMIC POLICIES CONTINUE TO BE HOTLY DEBATED WITHIN GOM. IMF IS BECOMING A TARGET OF CRITICISM AND LABOR IS SHOWING SIGNS OF RESTLESSNESS. END SUMMARY.

2. SLOWDOWN IN INDUSTRIAL ACTIVITY THAT BEGAN IN MID-76 AND WAS AGGRAVATED BY SEPTEMBER 1 DEVALUATION DOES NOT APPEAR TO HAVE BEEN REVERSED THOUGH IT MAY HAVE REACHED BOTTOM. AS THERE ARE NO DATA ON INDUSTRIAL ACTIVITY IN THE FIRST QUARTER, OUR REMARKS ARE QUALITATIVE. PRIVATE SECTOR INVESTMENT, WHICH DROPPED IN LAST QUARTER OF 1976 DOES NOT APPEAR TO HAVE REVIVED. PUBLIC SECTOR SPENDING, ON BOTH CURRENT AND CAPITAL ACCOUNTS, IS SAID TO BE RUNNING BELOW BUDGETED LEVELS DUE IN PART TO DELAYS DUE TO THE ADMINISTRATIVE REFORM AND IN PART TO THE NORMAL DELAYS IN SPENDING ASSOCIATED WITH A NEW ADMINISTRATION. INCREASED ACTIVITY IN THE PETROLEUM AND RELATED INDUSTRIES IS THE ONLY BRIGHT SPOT.

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3. GOM OFFICIALS MAINTAIN THEY HAVE ATTAINED IMF FIRST QUARTER TARGETS FOR MONEY SUPPLY AND BUDGET DEFICIT.

4. MEXICO'S CURRENT ACCOUNT DEFICIT IS SAID TO BE RUNNING BELOW PREVIOUS YEAR LEVELS, AND THE FIRST QUARTER DEFICIT IS LIKELY TO BE ABOUT \$400 MILLION. THIS IMPROVEMENT IS

DUE TO SLOWDOWN IN DOMESTIC ECONOMIC ACTIVITY AND AN INCREASE IN PETROLEUM AND COFFEE EXPORTS, THE LATTER BENEFITING FROM HIGHER WORLD PRICES.

5. EXCHANGE RATE HAS REMAINED BETWEEN 22.50 AND 23.00 PESOS SINCE LATTER PART OF JANUARY. THE MARGIN BETWEEN BUYING AND SELLING RATES HAS NARROWED WHICH WOULD SEEM TO INDICATE A MORE EFFICIENT MARKET. WHILE BANK OF MEXICO CONTINUES TO MAINTAIN IT IS LARGELY OUT OF THE MARKET, IT IS IN A POSITION TO INFLUENCE THE RATE BY CONTROLLING TO SOME DEGREE THE FOREIGN EXCHANGE ACTIVITIES OF PUBLIC SECTOR ENTITIES. CAPITAL FLIGHT APPEARS TO BE NEGLIGIBLE, OWING AS MUCH TO A LACK OF DOMESTIC LIQUIDITY AS TO OTHER FACTORS; CAPITAL REFLOWS, WHILE PROBABLY GREATER, ARE NOT SIGNIFICANT AS BEST WE CAN FIGURE. THEY SEEM TO BE TAKING THE FORM OF REPATRIATION OF DOLLAR CURRENCY MORE THAN INTER-BANK FLOWS. THESE NET REFLOWS PLUS RELATIVELY SMALL NET INFLOWS FROM PUBLIC SECTOR EXTERNAL BORROWING APPEAR TO BE THE BASIS FOR THE STABLE EXCHANGE RATE AS BANK OF MEXICO RESERVES ARE REPORTEDLY STABLE.

6. PRESIDENT SEEMS PERPLEXED BY COUNTRY'S PRESENT ECONOMIC SITUATION. GOM REALIZES THE INADEQUACIES OF ITS FORMER DEVELOPMENT MODEL, BUT IT HAS YET TO DEVISE A NEW STRATEGY. LIKEWISE, IT REALIZES THE NEED FOR FINANCIAL STABILITY, BUT IT IS RELUCTANT TO RUN THE POLITICAL RISKS INVOLVED IN TAKING THE STEPS USUALLY ASSOCIATED WITH ACHIEVING THIS STABILITY. IN PARTICULAR, GOM IS PREOCCUPIED BY RISK OF LABOR DISSATISFACTION WITH 10 PERCENT LID ON NEGOTIATED WAGE SETTLEMENTS. THIS IS RESULTING
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IN REPRESSED INFLATION AS THE GOVERNMENT IS RELUCTANT TO APPROVE PRICE INCREASES FOR MANUFACTURED PRODUCTS SUBJECT TO PRICE CONTROLS AND FOR PUBLIC SECTOR ENTITIES' PRICES.

7. NUMEROUS IDEAS ON A LONGER TERM DEVELOPMENT STRATEGY EXIST. THESE EMPHASIZE THE NEED TO ABANDON MEXICO'S PROTECTIONIST POLICIES AND CREATE THE BASIS FOR EXPORT-ORIENTED GROWTH. HERE AGAIN GOM IS RELUCTANT TO ACT BECAUSE OF OPPOSITION FROM DOMESTIC INDUSTRY IN MONOPOLISTIC POSITIONS AND THE SHORT-TERM IMPACT SUCH POLICIES MIGHT HAVE ON THE BALANCE OF PAYMENTS AND EMPLOYMENT.

8. AS USUAL IN MEXICO, THE COUNTRY'S ECONOMIC PROBLEMS ARE BEING BLAMED ON EXTERNAL FACTORS. IMF IS BECOMING A WHIPPING BOY, BY THE PRESIDENT PRIVATELY AND, IN THE LAST FEW DAYS, BY PRIVATE ECONOMISTS VIA THE MEXICAN PRESS. PRESIDENT, IN SPITE OF HIS EXPERIENCE AS FINANCE MINISTER, IS RELUCTANT TO TAKE STRONG STABILIZATION MEASURES AND APPEARS CONFUSED BY, OR UNDECIDED BECAUSE OF CONFLICTING

ADVICE FROM HIS CABINET. AS BEST WE CAN DETERMINE, THE CENTRAL BANK AND TREASURY ARE URGING STRONGER MEASURES, PARTICULARLY AS REGARDS PUBLIC SECTOR SPENDING, WHEREAS THE BUDGET AND PLANNING MINISTRY IS RECOMMENDING THAT ONLY THROUGH INCREASED PUBLIC SECTOR INVESTMENT SPENDING CAN BOTTLENECKS TO INCREASED OUTPUT BE REMOVED AND INFLATIONARY PRESSURES DAMPENED OVER THE MEDIUM TERM.

9. INFLATION IS A MAJOR POLITICAL AND ECONOMIC CONCERN OF THE GOVERNMENT AT THE MOMENT. BANK OF MEXICO ISSUED ITS

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C O N F I D E N T I A L SECTION 02 OF 02 MEXICO 04844

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PRICE INDICES FOR MARCH WHICH SHOWED A SLOWDOWN IN INCREASES IN MEXICO CITY'S CPI. THE MONTH TO MONTH INCREASE FOR MARCH WAS 1.5 PERCENT COMPARED TO 2.5 PERCENT IN FEBRUARY. THE NATIONAL CPI HAS BEEN INCREASING AT A SLIGHTLY FASTER RATE THAN THAT FOR MEXICO CITY, PROBABLY BECAUSE PRICE CONTROL ENFORCEMENT EFFORTS ARE MORE EFFECTIVE IN THE CAPITAL THAN IN THE MAJOR PROVINCIAL CITIES.

10. GOM HAS MOVED SLOWLY TO IMPLEMENT ECONOMIC POLICIES. SOME PUBLIC SECTOR PRICES ARE BEING RAISED, BUT ONLY PIECEMEAL. INTEREST RATES ARE TO BE DETERMINED BY MARKET CONDITIONS, BUT BANK OF MEXICO WILL PROBABLY MOVE ONLY GRADUALLY TOWARD MARKET-DETERMINED INTEREST RATES. LEGAL RESERVE REQUIREMENTS FOR BANKS HAVE BEEN MODIFIED, BUT GOM OFFICIALS MAINTAIN THAT THIS WILL NOT, IN NEAR FUTURE, RESULT IN INCREASED CREDIT AVAILABILITIES FOR PRIVATE SECTOR. SOME IMPORT-LICENSING REQUIREMENTS HAVE BEEN DROPPED, BUT THIS APPEARS TO BE A MEASURE TO REDUCE PAPER

WORK MORE THAN A TRADE-LIBERALIZATION MEASURE. EXPORT
REBATES HAVE BEEN RE-INTRODUCED, BUT THIS SEEMS TO INDICATE
FAILURE OF THEIR EXCHANGE RATE CHANGE TO MAKE MEXICO'S
MANUFACTURED EXPORTS COMPETITIVE AS THE REBATES WERE
DROPPED AT THE TIME OF THE DEVALUATION. THERE HAVE BEEN
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NO PUBLIC STATEMENTS ON THE BUDGET SINCE IT WAS INTRODUCED
LAST DECEMBER, THOUGH VARIOUS GOM OFFICIALS HAVE SAID
PRIVATELY THAT THEIR CURRENT EXPENDITURE BUDGETS ARE BEING
CUT.

11. AFTER 22 YEARS OF RELATIVE ECONOMIC STABILITY, MEXICO
AND MORE SPECIFICALLY ITS PRESIDENT ARE ON THE HORNS OF A
DILEMMA. THE OBVIOUS ECONOMIC SOLUTIONS RUN POLITICAL
RISKS. THE CURRENT ECONOMIC PROBLEMS - INFLATION, STAGNATION
AND INCREASING UNEMPLOYMENT - HAVE POLITICAL RISKS.
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